

FAST FOOD FRANCHISES: MARKET POTENTIALS FOR AGRICULTURAL PRODUCTS IN FOREIGN AND DOMESTIC MARKETS



REPRINTED FROM THE MARKETING AND TRANSPORTATION SITUATION • FEB. 1975

FAST FOOD FRANCHISES: MARKET POTENTIALS FOR AGRICULTURAL PRODUCTS IN FOREIGN AND DOMESTIC MARKETS

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ABSTRACT: This report summarizes the results of a pilot study of the eight largest fast food franchises with foreign outlets. The purpose of the study was to provide the Foreign Agricultural Service, USDA with information concerning the foreign expansion activities of this rapidly growing industry which might be useful in planning foreign market development programs. These fast food chains expect to increase the number of U.S. outlets 50 percent by 1979 and reach a sales volume of \$9 billion. Foreign expansion plans are even more optimistic, 250 percent by 1979. Export potential for U.S. food products in foreign fast food outlets is estimated at \$820 million by 1979. The No. 1 country targeted for foreign expansion by almost all fast food companies is Japan, followed by Australia, Europe, and Canada.

KEY WORDS: Fast foods, franchises, expansion, sales, outlets.

The fast food franchise industry has expanded more rapidly in the past decade than any other food service industry segment. Sales of the fast food industry increased nearly 20 percent in 1974 compared with a total restaurant industry growth of 8 percent.¹ Although most of the firms have been in existence less than 15 years, and have doubled and tripled in size during that time, they appear well organized, have a great deal of operational knowhow, and an optimistic outlook for the future.

The rapid growth of franchise systems in the food service industry in the late 1950's and 1960's had several roots. First, changing American lifestyles—consisting of more travel, rising discretionary income, more working wives, and the greater independence of teenagers and young adults—increased the need for a food service concept which would save time, provide good quality, and at the same time be economical. Secondly, the capital-intensive nature of the fast food franchise system suited the 1960's economic environment of relatively tight labor and easy money policies. Thirdly, technology was available to engineer mass production methods and raise productivity in an industry which had been characterized by small units and resistance to change.

The rapid growth of the fast food industry in the 1960's slowed somewhat in recent years as the U.S. market approached saturation. As a result, the industry turned increasingly to foreign markets for expansion. These expansion plans have been accelerated by fundamental improvements in the economies of many potential foreign markets and the impact of increased affluence on the lifestyles of these populations.

Both U.S. and locally owned fast food enterprises have made great progress in introducing western-style fast food operations into foreign countries. In Japan, the annual growth rate of the fast food industry is estimated by trade sources to be 50 percent. Such growth indicates the possibility of a substantial foreign market for U.S. processed and semiprocessed food products.

This article is based on material developed in a study of the foreign expansion plans of the fast food industry. Such information, particularly on potential uses of processed products, was requested by USDA's Foreign Agricultural Service (FAS), for use in planning foreign market development programs. The Economic Research Service's interest focused primarily on the impact of fast food franchisers on domestic use of agricultural commodities. This article presents information on the size and structure of the domestic and foreign fast food industry, growth trends, present usage of food, and growth prospects.

¹"Franchising in the Economy 1972-74," U.S. Dept. of Commerce, Feb. 1974.

Study Plans and Methods

Data show that 34 U.S. fast food franchisers account for 80 percent of domestic sales and nearly 100 percent of U.S.-owned foreign fast food operations.² Subsequent discussions with trade association and food industry people indicated that less than 15 had foreign fast food outlets. The sample used for the pilot study, and on which research results are based, was confined to the eight largest firms with foreign units. Personal interviews were conducted, in most cases with the senior vice-president in charge of international operations for marketing, to obtain information for the study. Firms visited were Hueblein, Inc. (Kentucky Fried Chicken, International Division, Hartford, Conn. and the Kentucky Fried Division, U.S. Operations in Louisville, Ky.); MacDonald's, Oak Park, Ill.; Bonanza International, Dallas, Tex.; International Dairy Queen, Minneapolis, Minn.; Mr. Donut of America, Westwood, Mass.; Pizza Hut, Wichita, Kansas; A&W International, Santa Monica, Calif.; and Burger King, International Division, Minneapolis, Minn. Contacts were made during February to June 1974. Although a structured interview outline was used to insure uniformity of information, some data gaps developed, either because specific data were lacking, particularly regarding foreign food use, or were considered proprietary in nature and thus, not available.

Although research results are based on only eight firms in the fast food industry, these firms represented 52 percent (\$4.5 billion) of total U.S. sales for the industry in 1973 and 45 percent (16,362) of the total number of sales outlets (table 13 and 14). Of even greater importance, the sample firms represent the major share of U.S. fast food firms having foreign operations in 1973. Thus, the research findings can be considered, in most instances, indicative of trends and changes occurring in the fast food industry.

Domestic Sales and Outlets

Census data on the away-from-home eating industry show total sales of \$30.33 billion in 1973. The restaurant, cafeteria, and lunchroom segment, of which the fast food industry is a part, accounted for \$23.8 billion of that total.³ According to the Commerce survey of franchising, the 214 fast food franchise companies in the U.S. represent \$8 billion of that total (table 14). These companies had 36,223 retail sales outlets and 1,622 foreign sales units.⁴ Of particular significance is the fact that the fast food industry represents almost a third of the away-from-home eating market in terms of retail sales. Thus, if the fast food industry continues to grow at double the

rate of the total restaurant industry, the fast food segment will increase its market share and likely become an even more dominant factor in the away-from-home eating market.

The Commerce survey also reveals that the company-owned segment accounts for approximately 25 percent of total establishments. But they account for 37 percent of the total sales of products and services. It is likely that company-owned stores' higher gross sales per unit may be due to the fact that they are newer, larger in size, and offer more of the new menu items developed by the company. Several of the larger companies contacted in this pilot survey indicated that they are opening more company-owned units rather than selling franchises to private individuals.

The five largest fast food companies account for more than 40 percent of the outlets and total sales (table 15). In terms of number of outlets, hamburgers rank as the most popular franchise food item followed by chicken, steak, and pizza, (table 16). Fast food restaurants selling hamburgers accounted for 55 percent of total sales in 1973, but the steak-type fast food operation was second with 20 percent, and the chicken category followed with 14 percent (table 17).

Foreign Sales and Outlets

It was difficult to obtain precise data on the location of fast food franchise units in foreign countries. The Commerce survey listed a total of 1,622 foreign units for the fast food industry in 1972. Canada had by far the most sales outlets of U.S. fast food companies. The United Kingdom, Australia, and Japan followed in that order.⁵ In the 1974 ERS survey, the eight sample firms had 1,833 units in foreign countries. Again, the pattern of distribution was quite similar to that found for the Commerce survey of franchisers. The only significant change was that Japan ranked third rather than fourth. The country and number of outlets in each foreign country operated by the U.S. sample firms are as follows:

Country	Estimated outlets-1974
	Number
Canada	880
Mexico	43
Caribbean	52
Europe	
United Kingdom	265
Other	56
Australia	194
Asia	
Japan	245
Other	23
Other	175
Total	1,833

¹ Includes South and Central America 17, Africa 38, New Zealand 15, Middle East 5.

⁵Ibid, p. 16, 17.

²Ibid.

³Monthly Retail Trades Report, Dec. 1973, Census Bureau, U.S. Dept of Commerce.

⁴Franchising in the Economy 1972-74, Feb. 1974, U.S. Dept. of Commerce, p. 17.

Table 13.--Number of outlets and sales of eight survey fast food firms, 1974

Type of outlet	Outlets		Sales	
	U.S.	Foreign	U.S.	Foreign
	Number		Mil. Dollars	
Franchisor outlets.....	2,858	442	988	132
Franchisee outlets.....	13,504	1,391	3,141	294
Total.....	16,362	1,833	4,129	426

Table 14.--U.S. fast food franchise industry--size and sales volume, 1972-74

Item	1972	1973	1974	Percentage changes	
				1972-73	1973-74
Franchisor outlets.....	6,319	7,587	8,919	20.1	17.6
Franchisee outlets.....	26,219	28,636	31,488	9.2	10.0
Total.....	32,538	36,223	40,407	11.3	11.6
Franchisor outlet sales (\$000).....	1,753,297	2,236,057	2,830,567	27.5	26.6
Franchisee outlet sales (\$000).....	5,044,108	5,756,776	6,722,391	14.1	16.8
Total sales (\$000).....	6,797,405	7,922,833	9,552,958	17.6	19.5

Source: "Franchising in the Economy 1972-74," U.S. Dept. of Commerce, Feb. 1974, p. 69. Data for 1974 estimated by respondents.

Table 15.--Distribution of fast food outlets by size of firm, 1972^{1/}

Size of firm	Franchising companies	Outlets		Sales	
		Number	Percent	Dol. (000)	Percent
1,001 and more.....	5	14,278	43.9	2,867,224	42.2
501 - 1,000.....	6	4,952	15.2	1,331,949	19.6
151 - 500.....	28	7,318	22.5	1,487,576	21.9
51 - 150.....	45	3,775	11.6	668,610	9.8
11 - 50.....	77	1,936	5.9	386,538	5.7
0 - 10.....	53	279	0.9	55,508	0.8
Total.....	214	32,538	100.0	6,797,405	100.0

^{1/}Source: Adopted from "Franchising in the Economy 1972-74," U.S. Dept. of Commerce, Feb. 1974, p. 69.

Table 16.--Distribution of fast food franchise outlets by type of menu, 1973-74

Major menu item	Outlets					
	1973			1974		
	Firms	Total	Franch- isors	Franch- isees	Total	Franch- isors
Chicken.....	21	5,099	927	4,172	5,788	1,091
Hamburgers, franks, roast beef, etc.....	82	20,914	2,854	18,060	22,589	3,243
Pizza.....	26	2,928	1,029	1,899	3,559	1,259
Mexican (Taco, etc.).....	14	1,039	329	710	1,180	401
Seafood.....	11	566	196	370	645	225
Pancakes, waffles.....	7	907	172	735	1,131	248
Steak, full menu.....	45	4,490	2,069	2,421	5,213	2,440
Sandwich and other.....	8	280	11	269	302	12
Total.....	214	36,223	7,587	28,636	40,407	8,919

Source: Adopted from "Franchising in the Economy 1972-74," U.S. Dept. of Commerce, Feb. 1974.

Table 17.--Distribution of fast food franchise sales by type of menu, 1973-74

Major menu item	Dollars (000)					
	1973			1974		
	Firms	Total	Franch- isors	Franch- isees	Total	Franch- isors
Chicken.....	21	1,130,762	218,993	911,769	1,306,161	259,833
Hamburgers, franks, roast beef, etc.....	82	4,417,485	949,259	3,468,226	5,249,651	1,190,404
Pizza.....	26	393,761	123,805	269,956	509,929	163,721
Mexican (Taco, etc.).....	14	132,180	51,125	81,055	159,442	63,694
Seafood.....	11	77,013	29,742	42,271	94,539	38,432
Pancakes, waffles.....	7	214,670	39,224	175,446	263,753	53,722
Steak, full menu.....	45	1,602,757	821,484	781,273	1,943,483	1,058,166
Sandwich and other.....	8	24,205	2,425	21,780	26,000	2,595
Total.....	214	7,992,833	2,236,057	5,756,776	9,552,958	2,830,567

Source: Adopted from "Franchising in the Economy 1972-74," U.S. Dept. of Commerce, Feb. 1974, pg. 70.

Commodity Usage

Food quantity data for domestic and foreign operations were sought from all eight sample survey firms. The emphasis was on major categories such as meat, poultry, cooking oils, and vegetables. A number of specialty products were omitted because they were not considered crucial to the objectives of the pilot study. In addition, the total usage figures reported here are extremely conservative since they do not include, in some instances, the foods used by noncompany owned franchise outlets. This is particularly true of the foreign operations.

The largest commodity used in domestic and foreign operations was meats, particularly beef and poultry; among bakery products, it was rolls; in the dairy products it was cheese; for fats and oils, the major item was cooking oils. On the vegetable side, the big usage was potatoes. The fast food industry can almost be characterized as a meat and potato industry. However, the trend seems to be for extending menus rather than limiting them and this should lead to a much greater variety of food products being used by the fast food industry in the years ahead, (table 18).

Food Cost Component of Sales

Two distinct trends emerged from a series of questions as to what part of total sales were accounted for by the cost of food. First, fast food sample firms featuring meat or poultry as a main entree had a food cost ranging from 41 percent to 46 percent of the total sales dollar. Those sample firm fast food operators having other than meat as a main entree had a food cost ranging from 29 percent to 34 percent.

Adequacy of Food Supply Sources

Most of the companies were well satisfied with their supply sources both on the U.S. and foreign sides. All of the companies have developed quality specifications for various foods, ingredients, paper supplies, equipment, etc. that go into the day-by-day operations of a fast food enterprise. Suppliers manufacture products to meet these quality specifications and, therefore, qualify as an approved supplier. Companies send franchisee operators annual lists of approved suppliers for specific foods, ingredients, and equipment.

In most instances, companies operate two types of distribution systems. Most fast food companies supply their own operations through regional distribution centers. A similar setup exists for franchisee operations except the franchise operators have an option of buying products from independent suppliers. Of course, foods purchased from independent suppliers must meet quality specifications as set forth in the franchise agreement.

On the foreign side, most companies experience some difficulties in finding local or third country suppliers to furnish products meeting their quality specifications and importing these products from the United States is expensive, particularly for companies just beginning and with low volume. It is likely that once sufficient volume is established, local suppliers will then become interested in developing products to meet the quality specifications needed for fast food operations. In the meantime, depending on the kind of fast food operations, specific types of food products will be imported from the United States. This also is true for equipment needs, since most of the fast food operations require custom-built equipment, which in turn requires considerable "R&D" investment by equipment manufacturers. It is likely that the U.S. equipment manufacturer will have a built-in advantage in the foreseeable future for supplying equipment for U.S. style foreign operations.

Some of the products being exported from the United States for foreign fast food franchise operations are fruit fillings and purees, flavor extracts, tomato products and spices, frozen chicken, frozen potatoes, ice cream flavor and topping items, and milkshake mix. The prevailing sentiment in the industry is that in the long run they will have to depend on local and third country suppliers to meet their needs for many of the major items used in their foreign operations. On the other hand, they believe there will still be large specialty product markets available for U.S. food manufacturers.

Growth and Expansion Plans

A series of questions were asked of each company executive interviewed concerning the growth rate of the company in the past 5 years and the growth rate anticipated in the next 5 years, both U.S. and foreign. The growth rate in the number of outlets in the U.S. from 1969 to 1974 varied considerably from company to company, but the overall average was 60 percent (table 19). This figure approximates the growth rate found in the USDC study which determined an annual rate of a little over 11 percent. On the foreign side, because of the much smaller base in 1969, the percent growth has been more spectacular, except for two companies. The average growth for the 1969-74 period in foreign units was 100 percent.

In looking ahead for the next 5 years, the company executives were much more optimistic about their foreign expansion plans than for their U.S. operations. While here again the individual firms' expansion plans for the United States vary considerably, ranging from a low of 21 percent by 1979 to a high of 167 percent, the average for all companies was 54 percent which is a continuance of the growth rate of the past 5 years. On the foreign side there is a great deal more optimism based on the belief that the same factors that operated in the United States to make this industry a rapidly

Table 18.--Food use by fast food franchise outlets, U.S. and foreign operations, 1973

	United States					Foreign		
	Fresh :	Frozen	: Canned	: Dehydrated	: Total :	Fresh :	Frozen	: Canned : Dehydrated: Total
	1,000 pounds							
Meat and poultry								
Beef.....	3,276	245,656	--	--	248,932	2,033	2,920	-- -- 4,953
Pork.....	10,496	--	115	--	10,611	88	--	-- 88
Poultry.....	650,000	1,122	--	--	651,122	400	418	-- -- 818
Total.....	663,772	246,778	115	--	910,665	2,521	3,338	-- -- 5,859
Seafood								
Fish.....	--	44,194	--	--	44,194	--	43	-- -- 43
Shrimp.....	--	1,785	--	--	1,785	--	13	-- -- 13
Total.....	--	45,979	--	--	45,979	--	56	-- -- 56
Bakery products								
Rolls 1/.....	123,787	--	--	--	123,787	2,212	--	-- -- 2,212
Bread 1/.....	4,954	--	--	--	4,954	94	--	-- -- 94
Pizza dough 1/.....	20,748	--	--	--	20,748	1,038	--	-- -- 1,038
Miscellaneous flour products 1/.....	22,190	--	--	--	22,190	1,084	--	-- -- 1,084
Fruit pies.....	76,662	--	--	--	76,662	--	--	-- -- --
Total 1/.....	248,341	--	--	--	248,341	4,428	--	-- -- 4,428
Dairy products								
Milk 2/.....	4,123	--	--	--	4,123	72	--	-- -- 72
Cheese 2/.....	372,335	--	--	--	372,335	22,940	--	-- -- 22,940
Cream 2/.....	316	--	--	--	316	7	--	-- -- 7
Butter 2/.....	7,431	--	--	--	7,431	146	--	-- -- 146
Sour cream 2/.....	913	--	--	--	913	18	--	-- -- 18
Cottage cheese 2/.....	5,047	--	--	--	5,047	100	--	-- -- 100
Milkshake mix.....	--	23,625	--	--	23,625	--	6,300	-- -- 6,300
Total.....	390,165	23,625	--	--	413,790	23,283	6,300	-- -- 29,583
Fats and Oils								
Margarine.....	--	--	--	--	2,739	55	--	-- -- 55
Cooking oil.....	--	--	166,346	--	166,346	--	--	-- 8,302
Imitation sour cream.....	--	--	--	--	6,848	131	--	-- -- 131
Total.....	--	--	166,346	--	175,933	186	--	-- 8,302
Produce								
Potatoes.....	41,090	733,280	2,178	3/23,678	840,226	2,801	7,638	-- -- 10,439
Onions.....	718	1,485	--	3/23,022	25,225	9	--	-- 612
Lettuce.....	18,262	--	--	--	18,262	349	--	-- -- 349
Mushrooms.....	--	--	73	--	73	--	--	-- 95
Total.....	60,070	774,765	2,251	46,700	883,786	3,159	7,638	95 612 11,504
Miscellaneous products								
Condiments.....	--	--	46,919	--	46,919	--	--	-- 4,038
Spices.....	--	--	35,379	--	35,379	--	--	-- 3,000
Salad dressing.....	--	--	19,427	--	19,427	--	--	-- --
Tomato sauce.....	--	--	582	--	582	--	--	-- 114
Baked beans.....	--	--	14,410	--	14,410	--	--	-- --
Fruit fillings.....	--	--	1,152	--	1,152	--	--	-- 686
Total.....	--	--	117,869	--	117,869	--	--	-- 7,838

1/Converted to wheat flour basis. 2/Fat solids basis. 3/Fresh equivalent.

expanding one are now operating in the rest of the world. All but two of the companies contacted expect to double in size, at a minimum, by 1979. On the average, these companies expect a 250 percent increase by 1979 in foreign outlets (table 20).

A number of countries were mentioned for expansion with an indication of the possible number of units going into these countries. The No. 1 country targeted for expansion by almost all companies is Japan, followed by Australia, Europe and Canada.

Japan was expected to take 35 percent of the total expansion outlets, Australia 27 percent, Europe 20 percent, Canada 15 percent, and Mexico 3 percent. Several companies expressed a great deal of interest in East European countries but so far have not made any serious attempts to penetrate these markets.

Fast food companies tend to view foreign market expansion differently than they do their U.S. expansion plans, particularly in the area of ownership. In the United States, the trend seems to be

Table 19.--Growth rate of eight survey fast food franchises, 1969-74

Firm	U.S. Market			Foreign Market		
	Outlets		Change	Outlets		Change
	1969	1974		1969	1974	
	Number		Percent	Number		Percent
A.....	185	450	143	1/	7	--
B.....	450	2,625	483	1/	150	--
C.....	1,888	3,987	111	200	725	262
D.....	3,603	3,953	10	384	384	0
E.....	300	1,400	367	6	70	1,066
F.....	190	320	68	14	131	835
G.....	656	1,177	79	12	22	83
H.....	2,950	2,450	-17	300	344	15
Total.....	10,222	16,362	60	916	1,833	100

1/Foreign operations began after 1969.

Table 20.--Expansion plans of eight survey fast food franchises for U.S. and foreign markets, 1974-1979

Firm	U.S. Market			Foreign Market		
	Outlets		Change	Outlets		Change
	1974	1979		1974	1979	
	Number		Percent	Number		Percent
A.....	450	1,200	167	7	200	2,757
B.....	2,625	4,600	75	150	2,500	1,567
C.....	3,987	5,130	29	725	1,725	138
D.....	3,953	4,800	21	384	650	69
E.....	1,400	2,900	107	70	336	380
F.....	320	600	88	131	450	244
G.....	1,177	2,181	85	22	100	355
H.....	2,450	3,700	51	344	450	31
Total.....	16,362	25,211	54	1,833	6,411	250

toward more company-owned rather than franchisee-owned sales outlets. The reason most often cited was "better control." On the foreign side, the emphasis is almost reversed, due mainly to the myriad of local government regulations, language difficulties, etc. attending introduction and development in foreign countries. The emphasis, as noted earlier, is for U.S. fast food firms to enter into agreements with local trading companies or individuals to operate the stores in these countries. This is particularly true in such developed areas as Japan, Europe, and Australia, and accounts, in part, for the more optimistic expansion plans on the foreign side than for the domestic market.

Appraisal of Market and Export Potentials

U.S. fast food franchisers expect to have almost 4,600 additional outlets operational in foreign countries by 1979. The estimated 4,600 plus the 1,833 in existence would total a little more than 6,400 units in 1979. Based on current average sales of about \$310,000 per foreign unit operated by sample firms, these sales units are estimated to be capable of generating more than \$2 billion in sales by 1979 without any adjustments for inflation.⁶ Since a weighted average of 41 percent of total sales represents food costs in the fast food sample firms, the market for food products could be as much as \$820 million. For the U.S. market, the eight sample firms would have, on the basis of an estimated 25,000 sales units by 1979, a sales volume of almost \$9 billion, not considering inflation.

⁶Average sales per unit, foreign and domestic were weighted to reflect the relative importance of sales units and volume of each sample firm. For foreign operated sales units, the weighted average for sample firms was \$310,386. For U.S. units it was \$354,049 per unit.

These data indicate that the fast food industry will continue to take an increasing share of the away-from-home eating market and as a result, represents a fast growing market for food producers and processors. Whether or not U.S. processed or semiprocessed food products will be able to penetrate the foreign fast food franchise operations will depend on a number of factors, some of them beyond the control of food manufacturers, such as tariff barriers and food regulations. In addition, local suppliers and third country suppliers, because of their proximity to the market and lower transportation costs, in many cases will be able to successfully compete on a price basis with U.S. food processors. At present, U.S. food processors have three advantages in competing with foreign supplier: technology; 15 years of experience in developing systems of distribution and production of ingredients meeting the quality specifications of fast food operations; and the capacity to produce for world markets. In some instances, fast food enterprises have integrated their operations from food production through processing and marketing.

What the double effect of inflation and recession, national and worldwide, will have on the fast food industry's growth is problematical. The fast food industry should not be more vulnerable to inflation than other segments of the away-from-home eating market. As a matter of fact, with the fast food industry's customer image of "good value" for food purchases, it might lead to an even larger share of the away-from-home eating market in recession periods. However, a cautionary note that must be sounded in the outlook for the fast food industry's growth and expansion is the current high cost of capital and land. Since the fast food industry is capital intensive and requires considerable amounts of real estate for site acquisition and development, high interest rates and land costs may inhibit expansion plans both foreign and domestic.

